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SUBJECT: Argentine Congress Approves GoA Expropriation of Flag
Carrier Aerolineas Argentinas

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Summary

¶1. (SBU) On December 17, the Argentine Senate approved a bill to expropriate the troubled national airline, Aerolineas Argentinas, and its smaller sister carrier Austral. The action followed a lower house vote on December 3, and marked the end of almost two decades of Spanish control of the flag carrier. President Cristina Fernandez de Kirchner is expected to sign the bill into law before the end of the year. The bill justifies the takeover by declaring the service provided by the carriers to be of vital public interest. The purchase price was not included in the bill but will be set by the GoA. The Senate's action took place after negotiations failed between Spanish owner Marsans and the GoA. It also ends months of bitter exchanges between Marsans and the GOA (and its union allies) over who is responsible for the two carriers' collapse. Marsans has indicated that the company will pursue international arbitration via the International Center for the Settlement of Investment Disputes (ICSID). Meanwhile, the two airlines continue to hemorrhage money, with daily losses estimated at almost US\$ 2 million. Many analysts see this action as another example of the GOA's stealth policy of increasing state or local investor participation in companies tied to key economic sectors that were largely privatized during the 1990s (ref B). END SUMMARY.

GoA Completes Expropriation of Flag Carrier

¶2. (SBU) On December 17, the Argentine Senate voted 42 to 21 to expropriate the troubled national flag carrier, Aerolineas Argentinas, and its sister carrier Austral, marking the end of almost two decades of Spanish control of the two airlines. The Senate bill justifies the takeover by declaring the service provided by the carriers to be of vital public interest, based on the vast size of the country and the fact that the carrier is the only airline providing service on numerous domestic routes. President Fernandez de Kirchner is expected to sign the bill into force before

the end of the year, thus completing the expropriation of both airlines from Spanish travel and tourism company "Marsans Group." The bill does not set a purchase or compensation price.

Senate Follows House Approval

13. (SBU) The Senate vote followed the December 3 lower house approval of the same measure (152-84, with one abstention). Local media quoted the language in the bill as stating that the country "cannot accept that public air transport in Argentina continues in the hands of a company that operates with notable incompetence." The bill further declares the company "of public utility and subject to expropriation."

14. (SBU) The two carriers had been privatized in 1991 to Spanish carrier Iberia, and sold in 2001 to Marsans. Aerolineas and Austral control about 80% of the domestic air market and reportedly operate all of their 33 routes at a loss. The two airlines employ some 9,000 workers combined. Aerolineas also flies to about 13 international destinations, depending on the season, although U.S. and European carriers carry the majority of international traffic.

Vote Ends Months of Torturous Negotiations

15. (SBU) The Senate's action took place after months of deadlocked negotiations involving the GoA, Marsans, and the Government of Spain (GoS). Marsans agreed in principle July 17 to sell both airlines to

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the GoA, at which point the GoA took over operational control (with formal transfer pending resolution of the purchase price). Media and industry contacts estimate that the GoA has since spent about \$220 million to cover payroll and other operating expenses. As part of the July agreement, each side pledged to determine a value for the companies or submit to third party review if they could not agree on the purchase price.

16. (SBU) The GoA's Valuation Tribunal estimated Aerolineas' net worth at negative US\$ 832 million, in contrast to Marsans' estimate of US\$ 330-540 million (as assessed by Credit Suisse). The Argentine Congress disallowed any third-party review in the final version of the bill, and indicated that it alone would fix the price. Nevertheless, the bill as passed does not establish a set level of compensation for the expropriation. Members of Congress and GoA officials have since been quoted in the press stating that the GoA should not pay anything for the carriers, or even that Marsans should pay the GoA for taking it over. Some legislators who voted for the expropriation have publicly floated the idea of paying Marsans a single peso (US\$ 0.30) as a purchase price.

The Blame Game

17. (SBU) This action ends - for now - months of bitter exchanges between the GoA and its union allies on one side, and Marsans (supported by some opposition politicians and media) on the other, over who is responsible for the two carriers' collapse, and how the carriers could be on the verge of bankruptcy (with an estimated US\$ 890 million in debt). The GoA, supported by many legislators, accuses Marsans of "hollowing out" the company (e.g., by selling planes and leasing them back to the company, overbooking fares, not fulfilling investment pledges, flying older and less fuel efficient planes, and scaling back less profitable routes). Perhaps in an effort to show that the GoA intends to invest in Aerolineas, the company signed a letter of intent in mid-December to purchase two Boeing 737-700s. (Note: funding for the purchase remains unclear.) Marsans publicly denies that its actions have harmed Aerolineas' financial position, and instead blames the GoA's own commercial air transport policies, lack of proper oversight, and its mandate of below-market tariffs (as set by the GoA). Marsans has also criticized the GOA for allowing unions to stage frequent, crippling

strikes.

¶8. (SBU) While many GoA officials and union leaders are celebrating this expropriation, some opposition and media figures argue that the public is entitled to know how the airlines could have failed. They point to the boom in international tourism to Argentina over the last several years, Aerolineas' virtual monopoly on most domestic routes, as well as its preferential airport service fees, fuel subsidies, and its service in a country whose size and road infrastructure shortfalls make flying the only transport option for many travelers.

Marsans reaction

¶9. (SBU) Marsans has repeatedly accused the GoA of planning to expropriate Aerolineas all along. Marsans alleges that the GoA teamed up with unions to disrupt operations and make the airlines virtually unmanageable, as a prelude to expropriation. In a December 17 press release, Marsans called the takeover "arbitrary and illegitimate" and stated its intention to sue the GoA under the auspices of ICSID. Marsans corporate director Vicente Munoz told local press the same day that the proper term for the GoA's action was "confiscation" and that "you Argentines will be the ones who have to pay for it." Munoz also noted that insufficient compensation would violate the July agreement.

¶10. (SBU) Spanish Embassy contacts confirmed to Emboffs that Marsans and the Spanish government officials are deeply angry at and

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frustrated with the GoA over its actions. However, they also confirm that Marsans acknowledged to the GoS months ago that it intended to sell Aerolineas anyway. The same contacts indicated that Marsans simply wants fair compensation for its assets. Regarding the ICSID suit, they said that Marsans understands that international arbitration could take years to complete, but that it was a "card" to use in negotiations with the GoA. They also noted that Marsans has many other interests in Argentina that it is keen to protect, so it does not want to irreparably harm its relationship with the GoA.

Money hemorrhaging continues

¶11. (SBU) Meanwhile, the GoA takeover has done little to address Aerolineas' infamously poor service and chronic labor conflicts, and both airlines continue to operate in the red. Aviation analysts and media reports contend that the two carriers' financial and operational problems will continue, and put daily losses at almost US\$ 2 million, or about US\$ 700 million annually. Actual GoA payments since the takeover of operations (noted para 6) represent over \$500 million annualized. Such expenses do not include the reported debt of about \$890 million that the GoA must assume.

¶12. (SBU) The same analysts say that Aerolineas' 9,200 employees represent an employee per plane ratio of about 344, far higher than the industry average of about 60-100. Media and Embassy industry contacts report that in the run-up to the 2009 congressional elections, GoA-run airlines may be pressured to hire even more employees. Aerolineas has been plagued by workers' strikes, flight delays, and cancellations for years. On the revenue side, according to a recent study by local economists Marcelo Celani and Miguel Kiguel, while the average airline tariff in Latin America runs \$1.24 per mile, it is just 54 cents in Argentina. This same study also found that since 2001, Argentina domestic aviation costs have grown far more than tariff increases in nominal terms. For example, while fuel costs rose 900% and salaries 200% since 2001, tariffs rose only 100%.

The "Argentinization" factor

¶13. (SBU) Many analysts have pointed to this action as another example of the GoA's effort to increase state or local investor participation in companies tied to key economic sectors that were largely privatized during the 1990s (ref B). This has already occurred in many sectors, including electricity, gas, water, rails, ports, mail service, and airports, and follows the GoA's recent nationalization of private pension fund assets.

Comment

¶14. (SBU) The expropriation marks the return of the once-vaunted Argentine flag carrier to Argentine control, though the assignation of blame for its failure in private hands is ongoing. While GoA and union officials' accusations that Marsans ruined Aerolineas are to be expected, increasingly common are allegations that Marsans' failure is an example of the breakdown of the "jungle of privatization" and unfettered deregulation. Although Marsans has not gained much traction in blaming its troubles on GoA and labor collusion and artificially low prices, it is noteworthy that since the GoA took control of the two airlines in July, there have been no strikes and on-time service has improved. While a purchase of Boeing aircraft would be a silver lining for the United States, the long-term impact of this action is probably deleterious for Argentina, as it raises further concerns about the safety of investing here.

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